BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF	)	
SUEZ WATER DELAWARE INC.	)	PSC DOCKET NO. 16-0163
FOR A GENERAL INCREAS IN RATES AND	)	
FOR A REVISION IN ITS GENERAL TARIFF	)	
(FILED FEBRUARY 5, 2016)	)	

DIRECT TESTIMONY OF

DAVID E. PETERSON

ON BEHALF OF THE STAFF OF THE

DELAWARE PUBLIC SERVICE COMMISSION

NOVEMBER 18, 2016

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is David E. Peterson. I am a Senior Consultant employed by Chesapeake Regulatory Consultants, Inc. ("CRC"). Our business address is 1698 Saefern Way, Annapolis, Maryland 21401-6529. I maintain an office in Dunkirk, Maryland.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN THE PUBLIC UTILITY FIELD?

A. I graduated with a Bachelor of Science degree in Economics from South Dakota State University in May of 1977. In 1983, I received a Master of Business Administration degree from the University of South Dakota. My graduate program included accounting and public utility courses at the University of Maryland.

In September 1977, I joined the Staff of the Fixed Utilities Division of the South Dakota Public Utilities Commission as a rate analyst. My responsibilities at the South Dakota Commission included analyzing and testifying on ratemaking matters arising in rate proceedings involving electric, gas, and telephone utilities.

Since leaving the South Dakota Commission in 1980, I have continued performing cost of service and revenue requirement analyses as a consultant. In December 1980, I joined the public utility consulting firm of Hess & Lim, Inc. I remained with that firm until August 1991, when I joined CRC. Over the years, I have analyzed filings by electric, natural gas, propane, telephone, water, wastewater, and steam utilities in connection with utility rate and certificate proceedings before federal and state regulatory commissions.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN PUBLIC UTILITY RATE PROCEEDINGS?

A. Yes. I have presented testimony in 155 other proceedings before the state regulatory commissions in Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Indiana, Kansas, Maine, Maryland, Montana, Nevada, New Jersey, New Mexico, New York, Pennsylvania, South Dakota, West Virginia, and Wyoming, and before the Federal Energy Regulatory Commission. Collectively, my testimonies have addressed the following topics: the appropriate test year, rate base, revenues, expenses, depreciation, taxes, capital structure, capital costs, rate of return, cost allocation, rate design, life-cycle analyses, affiliate transactions, mergers, acquisitions, and cost-tracking procedures.

In addition, I testified twice before the Energy Subcommittee of the Delaware House of Representatives on the issues of consolidated tax savings and tax normalization. Also, I have presented seminars on public utility regulation, revenues requirements, cost allocation, rate design, consolidated tax savings, income tax normalization and other ratemaking issues to the Delaware Public Service Commission, to the Commissioners and Staff of the Washington Utilities and Transportation Commission, and to the Colorado Office of Consumer Counsel.

II. SUMMARY

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. My appearance in this proceeding is on behalf of the Public Service Commission Staff ("Commission Staff").

Q. HAVE YOU TESTIFIED IN OTHER PROCEEDINGS BEFORE THE DELAWARE PUBLIC SERVICE COMMISSION?

A. Yes, I have. I submitted testimony in the following Delaware rate proceedings:

- Delaware Electric Cooperative (Docket No. 04-288);
- Tidewater Utilities, Inc. (Docket No. 06-145);
- Delmarva Power & Light Company (Docket Nos. 05-304, 11-258, 12-546, and 13-115); and
- Artesian Water Company (Docket No. 14-132).

My appearances in these proceedings were on behalf of the Commission Staff.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I was asked to assist the Commission Staff in analyzing SUEZ Water Delaware Inc.'s ("Suez" or "the Company") rate increase request and proposed rate changes for its water services in Delaware. Specifically, I was asked to prepare a detailed analysis of Suez's rate base and *pro forma* operating income under rates that are currently in effect. From these determinations I calculated Suez's present revenue deficiency. The purpose of my testimony is to present the results of my analysis to the Commission and to recommend alternative ratemaking treatments for several items included in the Company's claimed revenue requirement. Specifically, my testimony will address certain rate base, revenue, and expense issues. I also summarize the impact of the adjustments recommended by other Commission Staff witnesses on Suez's claimed revenue requirement.

Q. ARE YOU FAMILIAR WITH SUEZ'S FILING IN THIS PROCEEDING?

A. Yes, I am. I have reviewed the Direct Testimonies and Exhibits sponsored by the Company's witnesses relating to the issues that I address herein. I also reviewed the Company's responses to data requests of the Commission Staff and the Division of the Public Advocate ("DPA"), again relating to the issues that I address in my testimony.

Q. PLEASE SUMMARIZE SUEZ'S RATE REQUEST.

A. Suez's current rates became effective September 20, 2011, following a 6.8 percent increase authorized by the Commission at that time.

On February 5, 2016, Suez filed an Application with the Commission requesting a $4,943,665 or 19.6 percent annual revenue increase. However, Suez currently has a Distribution System Improvement Charge ("DSIC") rider in its tariff. At the effective date of interim rates in this proceeding, revenues that were previously collected under the DSIC rider are now being collected in Suez's base rates and the DSIC has been reset to zero. Prior to the implementation of temporary rates in this proceeding, Suez had been collecting $1,696,286 through its DSIC on an annual basis. Thus, if Suez's rate request is approved as proposed, its service revenues will increase incrementally by 13.1 percent rather than 19.6 percent, since Suez's customers were already paying the DSIC rider charges.

Subsequent to its original filing in this proceeding, Suez filed three updated and modified revenue requirement studies. Suez's most recent updated filing, submitted on October 11, 2016, indicates a $5,707,482 revenue deficiency, including the roll-in of DSIC revenues. Each of Suez's filings were based on a test period ended June 30, 2016, a 7.89 percent return on rate base, and a 10.25 percent return on equity capitalization.

Q. DO YOU ACCEPT THE TEST PERIOD CHOSEN BY SUEZ?

A. Yes, I do. A recently completed, actual test period is preferable to a speculative forecasted test period. Therefore, I support the test period chosen by Suez in this proceeding and have relied on it in my revenue requirement analysis. In addition, the Commission Staff is relying on Suez's most recent revenue requirement filing on October 11, 2016, as the starting point for our analyses. The October filing reflects Suez's actual test period plant investment and operating results. Suez's October filing also reflects centralized management services related costs allocated to Suez assuming the previously approved service agreement remains in effect. In this proceeding, Suez is requesting approval for a new management services agreement. The Commission Staff is not prepared at this time to make a final recommendation on Suez's request in that regard, however, as explained in the testimony of Staff Witness Amy Woodward. Therefore, my revenue requirement analysis at this time reflects the currently approved management services agreement. If a new agreement is adopted later in this proceeding, the revenue requirement impact of any changes will be reflected in an updated revenue requirement determination.

Q. EARLIER YOU STATED THAT YOU WERE ASSIGNED THE TASK TO SUMMARIZE THE IMPACT OF ALL OF THE COMMISSION STAFF'S ADJUSTMENTS TO SUEZ'S CLAIMED REVENUE REQUIREMENT. HOW HAVE YOU ORGANIZED THE COMMISSION STAFF'S FINDINGS AND RECOMMENDATIONS?

A. My revenue requirement analysis, which is described in more detail later, incorporates my recommendations and adjustments to Suez's rate request as well as the recommendations and adjustments of several other Commission Staff witnesses. The following individuals are presenting recommendations on behalf of Commission Staff. The issues on which each are testifying are also shown on the list below.

• Amy J. Woodward	property taxes, credit card payments and management service fees
• Toni M. Loper	purchased water, Delaware River Basin Charge, rate case expense, and antenna revenues
• Joshua Bowman	power costs, chemicals cost, sewer connection costs, depreciation expense and meter investment
• David Parcell	capital structure and rate of return
• Brian Kalcic	class cost allocation and rate design

To the extent that the Staff witnesses listed above are recommending adjustments to Suez's claimed revenue requirement, I have incorporated those adjustments in my revenue requirement analysis.

Q. HAVE YOU PREPARED AN EXHIBIT SUMMARIZING THE COMMISSION STAFF'S RECOMMENDATIONS AND ADJUSTMENTS RELATIVE TO THE COMPANY'S CLAIMED REVENUE REQUIREMENT?

A. Yes, I have. Exhibit DEP-1 attached to my testimony summarizes the Commission Staff's determination of Suez's revenue deficiency, excluding the effects of changes to the management services agreement. Exhibit DEP-1, Schedule 1, page 1, summarizes the cumulative effect of the Commission Staff's recommendations and adjustments on Suez's claimed revenue requirement. From this schedule, I calculated that Suez's current rates produce a 5.51 percent return on rate base. Commission Staff witness Mr. David Parcell is testifying in this proceeding that Suez requires a 7.38 percent overall return on rate base. Mr. Parcell's overall return includes a 9.3 percent return allowance on common equity capital. Therefore, on my Schedule 1, I show that Suez's annual revenues will have to be increased by

$2,847,250 in order to yield the 7.38 percent overall return that Mr. Parcell recommends, rather than the $5.7 million revenue deficiency shown in Suez's October updated filing.

Exhibit DEP-1, Schedule 2, is a multi-page schedule detailing my determination of Suez's rate base for the test ended June 30, 2016. Schedule 3 shows my calculation of Suez's *pro forma* earnings under present rates. The adjustments that bridge Suez's updated revenue requirement analysis to my *pro forma* determination are shown in Column E on the first page of Schedules 2 and 3. The Commission Staff witness that is sponsoring each adjustment is identified at the bottom of the column in which the adjustment appears.

In the sections of my testimony that follow, I address the rate base, revenue, and expense adjustments to Suez's claimed revenue deficiency that I am sponsoring. Issues sponsored by other Staff witnesses are discussed in their individual testimonies, but are also reflected in my revenue requirement calculation.

III. PETERSON'S RATE BASE ADJUSTMENTS

A. Cash Working Capital

Q. FOR WHAT PURPOSE SHOULD A CASH WORKING CAPITAL ALLOWANCE BE INCLUDED IN RATE BASE?

A. A cash working capital allowance should be included in rate base to compensate investors for investor-supplied funds, if any, used to provide the day-to-day cash needs of the utility. These cash needs are measured in a lead-lag study. Specifically, a lead-lag study measures the time between (1) the provision of service to utility customers and the receipt of revenue for that service by the utility, and (2) the provision of service by the utility and its disbursements to employees and vendors in payment for the associated cost of those services. The difference between the revenue "lag" and the expense "lead" is expressed in days. The difference, which can be either a net lag or a net lead, multiplied by the average daily cash operating expenses, quantifies the cash working capital required for, or available from utility operations.

Q. DID SUEZ PRESENT A LEAD-LAG STUDY IN THIS PROCEEDING?

A. Suez witness Charles E. Loy addresses the cash working capital issue in his Direct Testimony. Mr. Loy explained that rather than conducting a new, costly lead-lag study for this proceeding, the Company relied on its 2011 lead-lag study updated for test period expenses in this case and updated for the recent change from quarterly billing to monthly billing. In addition, Mr. Loy included only 80 percent of his calculated cash working capital requirement in rate base "to assure that the requested amount is significantly lower than an amount from a full blown study conducted with current Test Year data."[1] Thus, Suez's proposed rate base includes an $881,133 allowance for cash working capital.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO MR. LOY'S PROPOSED CASH WORKING CAPITAL ALLOWANCE?

A. Yes, I am. I am proposing the following three adjustments to Mr. Loy's cash working capital allowance:

- Reduce revenue lag days by 9.39 days; from 51.80 days to 42.41 days;
- Include recognition of taxes other than income in the lead-lag calculation; and
- Include interest on long-term debt in the lead-lag calculation.

[1] Direct Testimony of Charles E. Loy, page 14, lines 11-15.

Q. WHY IS IT APPROPRIATE FOR YOU REDUCE THE REVENUE LAG BY 9.39 DAYS?

A. I stated previously that Mr. Loy adjusted the revenue lag calculated in the 2011 lead-lag study to account for the Company's conversion from quarterly billing to monthly billing. Included in the 51.80-day total revenue lag that Mr. Loy calculated on an adjusted basis, however, is an average monthly collection lag of 34.39 days. This means that, on average, customers pay their monthly statement approximately 34 days after the bill is sent. But, Suez is proposing to amend its tariff to require that monthly statements be paid within 20 days following the billing date. Thereafter, after the 25th day following the billing date, Suez intends to assess a late payment charge to late paying customers. The late payment charge revenue, if retained by the Company, compensates the Company for the additional working capital requirements arising from delinquent payments. Thus, the collection lag should be no longer than 25 days, rather than the 34.39 days that Suez claimed. To reflect a collection lag exceeding 25 days in the revenue lag calculation compensates the utility twice for the working capital requirements for late paying customers; once through the revenue lag calculation and a second time through the collection of late payment charges. Therefore, I have reduced the revenue lag by 9.39 days to reflect a 20-day collection lag. Later in my testimony I describe a revenue adjustment to remove late payment revenues from the revenue requirement calculation. The Company should retain those revenues, below the line, as compensation for the additional working capital requirements resulting from late paying customers.

Q. DID MR. LOY INCLUDE IN HIS LEAD-LAG CALCULATIONS THE NET LAG ASSOCIATED WITH THE COMPANY'S TAX PAYMENTS OTHER THAN INCOME TANXES?

A. No, he did not. While the 2011 lead-lag study from which Mr. Loy's cash working capital calculations were base included recognition of the net expense leads and lags associated with taxes other than income, his analysis is this proceeding excluded explicit recognition of those net leads and lags. Rather, Mr. Loy included a separate rate base allowance for prepaid taxes and certain other prepaid expenses based on their test period average balances.

Q. HOW SHOULD TAXES OTHER THAN INCOME BE TREATED FOR WORKING CAPITAL PURPOSES?

A. Since the lead-lag analysis already specifically measured the lead and lag days associated with Suez's payments of taxes other than income, the related expenses and their associated lead and lag days should be reflected in the lead-lag calculation. This procedure will result in a more accurate and reliable measurement of the Company's actual working cash requirement rather than simply including an average balance in rate base. Therefore, on my Exhibit DEP-1, Schedule 2, page 3, I included test year taxes other than income and an associated negative 90.96-day expense lead to reflect the prepayment status of those tax payments.

Q. WHY IS IT APPROPRIATE TO RECOGNIZE INTEREST EXPENSE ON LONG-TERM DEBT IN THE LEAD-LAG CALCULATION?

A. The post-payment of interest expense after revenues are collected from customers for that expense creates a significant source of cash working capital that can be used by the Company for any legitimate corporate purpose. Therefore, this source of funds should be recognized in the lead-lag analysis. There are contractual requirements associated with debt interest payments that obligate Suez to make specified payments on certain dates. In this respect, the debt interest portion of Suez's return allowance more closely resembles its other cash operating expenses, which are recognized in the lead-lag study. Therefore, the average payment lead for long-term debt should be separately recognized in the lead/lag calculation. Long-term debt is paid semi-annually, creating a 91.25-day expense lead. I have included long-term debt interest in my calculation of Suez's cash working capital requirement.

In sum, as shown on Exhibit DEP-1, Schedule 2, page 3, my three adjustments to Mr. Loy's calculation of a working capital allowance largely offset each other, indicating an approximate $31,000 larger requirement than that calculated by Mr. Loy. In the next section of my testimony, however, I describe my recommendation to reduce rate base by $568,171, relating to my position on the treatment of prepaid expenses in the lead-lag calculation.

B. Prepayments

Q. PLEASE EXPLAIN YOUR RECOMMENDED NEGATIVE $568,171 RATE BASE ADJUSTMENT FOR PREPAYMENTS.

A. In a previous response, I explained my adjustment to the cash working capital calculation to include the annual payment and expense lead days associated with the Company's net prepayment of taxes other than income. To include a separate rate base allowance for the average balance of prepayments would double-count the working capital requirement for those tax payments. Therefore, it is appropriate and necessary for me to exclude the separate rate base allowance for prepayments that Mr. Loy included in his rate base calculation. The working capital effects of prepaid taxes other than income already have been recognized in my lead-lag calculation.

C. Rate Base Adjustments Summary

Q. PLEASE SUMMARIZE YOUR RECOMMENDED RATE BASE.

Mr. Loy proposed a $92.6 million rate base for Suez's water service in Delaware.

Staff's three rate base adjustments, which are summarized on Exhibit DEP-1, Schedule 2, page 2, reduce the Company's claimed rate base by approximately $3.1 million. Therefore, I recommend that the Commission set Suez's rate base at approximately $89.5 million, as detailed on my Exhibit DEP-1, Schedule 2, page 1.

IV. PETERSON'S INCOME ADJUSTMENTS

Q. WHERE IN EXHIBIT DEP-1 DO YOU SHOW THE COMMISSION STAFF'S ADJUSTMENTS TO SUEZ'S CALCULATION OF *PRO FORMA* INCOME UNDER PRESENT RATES?

A. All of the Commission Staff's income adjustments are summarized on Exhibit DEP-1, Schedule 3, pages 2, 2a, 2b, and 2c. These schedules show the revenue, expense, tax and net income effects of the Commission Staff's adjustments to Suez's updated test year presentation in this proceeding. The remaining pages in Schedule 3 detail the development of my recommended revenue and expense adjustments. Schedules supporting the revenue and expense adjustments sponsored by other Staff witnesses are contained in the testimony of the witness sponsoring the adjustment.

A. DuPont/Edgemoor Revenues

Q. WHAT DID SUEZ INCLUDE IN ITS REVENUE REQUIREMENT STUDY FOR SALES TO ITS INDUSTRIAL CUSTOMER DUPONT/EDGEMOOR?

A. Mr. Loy eliminated all test period sales and revenues for that customer in his revenue requirement study. His adjustment for DuPont/Edgemoor reduced test period revenues by $1,098,251.

Q. HAS DUPONT/EDGEMOOR FORMALLY NOTIFIED THE COMPANY OF ITS INTENTION TO DISCONTINUE SERVICE?

A. No. Although, apparently there has been media coverage of the closing, the customer has not formally notified Suez of an intention to discontinue service completely.[2]

Q. HAVE YOU REVIEWED DUPONT'S WATER PURCHASES FOR THE TEST PERIOD?

A. Yes, I have. I have listed DuPont's test period monthly water purchases from Suez on my Exhibit DEP-1, Schedule 3, page 3. This schedule shows that Dupont's water purchases declined significantly starting December 2015 and again in May 2016. Even with the most recent decline, however, DuPont was still purchasing a significant amount of water from Suez (9,818 MG in May 2016 and 6,991 MG in June 2016). Since DuPont continues to purchase significant, albeit lower, water volumes, it would be inappropriate to simply ignore sales and revenues from that customer as Mr. Loy has done in his revenue requirement study.

Q. WHAT DO YOU RECOMMEND?

A. It may be unreasonable to think that sales to DuPont will revert to pre-December 2015 levels or even to pre-May 2016 levels. Without any indication of final termination of service from DuPont, however, it does not seem unreasonable that monthly sales could continue indefinitely at the levels seen in May and June 2016. Therefore, I added back a total of 100,854 MG of water and $348,944 of revenues for DuPont, including $24,345 of DSIC revenues, based on annualizing the average sales volumes for that customer during May and June of 2016. My

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[2] Suez response to DPA-1.11.

DuPont/Edgemoor revenue adjustments are summarized on Exhibit DEP-1, Schedule 3, page 3.

B. Late Payment Revenues

Q. WHAT ADJUSTMENT ARE YOU PROPOSING FOR LATE PAYMENT REVENUES?

A. Suez's filing includes a $134,605 credit to the cost of service reflecting the three-year average level of revenues received from the Company's late payment charges. In the prior section of my testimony dealing with the cash working capital issue, I stated that late payment revenues are compensation to the Company for the working capital requirements created by late-paying customers. If late payment charges are returned to customers in the form of a credit to the cost of service, the Company will not be compensated for all of its cash working capital requirements. Thus, it is appropriate to exclude late payment revenues from the determination of Suez's revenue requirement. Of course, if the Commission determines that Mr. Loy's calculation of the collection and revenue lags is more appropriate than that of mine, my late payment revenue adjustment should be reversed. My adjustment reduces revenues under present rates by $134,605.

C. Payroll Expense

Q. IN WHAT WAYS DID SUEZ ADJUST ITS TEST PERIOD LABOR COSTS?

A. Suez added to test period labor costs allowances for positions that were vacant during the test period, normalized levels of bonuses and incentive pay, and post-test period wage and salary increases.

Q. IS SUEZ'S LABOR EXPENSE REQUEST REASONABLE?

A. No, not entirely. I will address my objection to including Suez's incentive compensation expenses in rates in the next section of my testimony. In addition, it is wrong to set rates assuming the Company will have a full complement of employees at all times; *i.e.*, no vacant positions throughout the year. No vacant positions is an unrealistic assumption for a company the size of Suez. Any vacancies that do occur reduce Suez's labor costs. Thus, assuming a full complement of employees, as Suez has done in constructing its payroll cost adjustment, overstates Suez's payroll expense.

Q. WHAT IS YOUR RECOMMENDATION CONCERNING SUEZ'S PAYROLL COSTS?

A. In response to a DPA discovery request in this proceeding, Suez provided an analysis which annualized salaries and wages for all Suez employees that were on the payroll as of the end of the test period, June 30, 2016.[3] I relied on this analysis because, in effect, it annualizes actual payroll increases occurring through the end of the test period and it reflects the actual level of employment and job vacancies as of the end of the test period. Thus, my payroll amount is a more accurate portrayal of Suez's labor costs going forward. My adjustments to payroll expense are summarized on my Schedule 3, page 4.

D. Incentive Compensation

Q. DOES SUEZ OFFER EMPLOYEES AN INCENTIVE COMPENSATION PLAN?

A. Yes, it does. Suez offers non-exempt/non-union employees a Non-Exempt Incentive Plan and offers all exempt employees a Short-Term Incentive Plan ("STIP"). Mr. Loy included a normalized level of bonuses and incentive compensation costs in his revenue requirement calculation based on the average payout rates under both plans over the period 2012 through September 30, 2015.

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[3] Suez response to DPA-1.75 Attachment (7/1/16).

Q. IS IT APPROPRIATE FOR THE COMPANY TO HAVE INCENTIVE COMPENSATION PLANS?

A. Incentive pay has become prevalent in many industries, including public utilities. Generally, I do not have a problem with utilities motivating key employees through incentive compensation plans. But, I have consistently objected in rate proceeding to recognizing in utility rates incentive payments made under plans that were primarily designed to promote shareholder interests rather than employee and ratepayer interests.

Q. IS IT REASONABLE TO CONCLUDE THAT THE PURPOSES OF SUEZ'S BONUS AND INCENTIVE PLANS ARE TO PROMOTE EMPLOYEE SAFETY AND RATEPAYER INTERESTS RATHER THAN SHAREHOLDER INTERESTS?

A. That may be a fair conclusion with respect to the Non-Exempt Incentive Program, but there is no support for that conclusion with respect to the STIP. A comparison of the stated purpose of each plan makes that distinction quite clear. Following is the stated purpose of the Non-Exempt Incentive Program:

> "Purpose: The program supports United Water's business ideals by recognizing efforts of non-exempt employees in contributing to the success of the Company's environmental

> health and safety performance and our overall corporate objectives."[4]

Compare that stated purpose with the one contained in the STIP, as follows:

> "Purpose: The Short Term Incentive Plan (STIP) is an annual compensation plan that supports United Water's business objectives by:
>
> - Providing an annual incentive strategy that drives performance toward objectives critical to creating shareholder value.
> - Offering competitive cash compensation opportunities to all eligible employees.
> - Awarding outstanding achievement among employees who can directly impact United Water's results.
> - Providing cash award for both qualitative and quantitative results.
> - Providing cash compensation opportunities for making sound business decisions that impact the company's financial performance and the overall success of Suez."[5]

Clearly, under the STIP the interests of stockholders are placed far above those of employees and Delaware ratepayers. I have no objection to including in rates the normalized level of costs for the Non-Exempt Incentive Program as Suez proposed because of the emphasis of that program on environmental health and safety. It would not be appropriate, however, to recognize in rates any costs incurred under the STIP because of the way that the Company has structured that program to put the Company's financial interests above employee and ratepayer interests. The goals to increase shareholder value and the company's financial performance that are pervasive in STIP are inconsistent with ratepayers' goal of receiving service at the lowest reasonable price. In fact, there is a perverse incentive under the STIP

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[4] Suez response to DPA-1.91 Attachment, page 2.
[5] Suez response to DPA-1.92 Attachment, page 2.

for the Company to artificially inflate requests for rate relief, to maintain excessive rate levels and to suppress operating expenses and capital investment. Since stockholders are the primary beneficiaries when Suez achieves its financial goals, stockholders rather than Delaware ratepayers should pay for the STIP awards. Therefore, I recommend that incentive payments made under the STIP be excluded from Suez's recoverable costs in this proceeding. My adjustment to exclude STIP costs from rates is own on Schedule 3, page 5. My incentive compensation adjustment reduces Suez's claimed expenses by $145,327.

E. Watershed Control Expense

Q. WHAT DID THE COMPANY INCLUDE IN ITS FILING RELATING TO WATERSHED CONTROL PLAN COSTS?

A. Suez incurred approximately $199,000 of costs associated with watershed control planning between April 2012 and June 2016. The Company proposes to amortize the total of these expenditures over the next five years through a $39,811 annual amortization allowance.

Q. IS SUEZ'S PROPOSAL REASONABLE?

A. No, it is not. As I understand it, Suez made no request, nor did the Commission authorize the Company to defer watershed control planning costs during the period April 2012 through June 2016. Without Commission authorization for deferred accounting treatment, the costs should have been, and I am certain they were in fact, expensed in the years in which the costs were incurred. That is, these costs have already been recognized in Suez's earnings in prior years. To allow recovery now for these prior period costs would be tantamount to retroactive ratemaking, a practice that should not be allowed by the Commission. It is inappropriate for the Company to recover prior period costs absent a specific accounting directive authorizing deferred accounting treatment. Therefore, I have removed Suez's amortization request in my revenue requirement determination, as shown on my Schedule 3, page 6. My adjustment reduces Suez's claimed expenses by $25,586.

F. Employee Benefits

Q. PLEASE DESCRIBE YOUR ADJUSTMET TO SUEZ'S EMPLOYEE BENEFITS CLAIM.

A. Suez's adjusted employee benefits claim includes allowances for medical, dental, and health insurance for positions that were vacant when the calculation was made. Earlier in my testimony I explained that my payroll cost adjustment was based on actual employment levels as of the end of the test period, June 30, 2016. In order to match employee benefit costs with employment levels and payroll expense it is necessary for me to remove the claimed allowances for insurances for vacant positions. Thus, on my Schedule 3, page 7, I show the impact of removing insurance allowances for the vacant positions identified in the Company's original filing. My adjustment reduces claimed test period expenses by $62,683.

G. Relocation Expense

Q. WHAT AMOUNT OF RELOCATION EXPENSE WAS INCURRED DURING THE TEST PERIOD?

A. Suez's test period operating results included $24,144 for expenses incurred in the relocation of Suez's Delaware Operations Manager, Mr. Larry Finnicum.

Q. ARE RELOCATION EXPENSES A NORMAL OR ROUTINE EXPENSE FOR THE COMPANY?

A. No, they are not. In fact, Mr. Finnicum's relocation costs are the only such costs that the Company has incurred since at least 2011.[6]

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[6] Suez response to DPA-1.90.

Q. WHAT THEN IS THE APPROPRIATE RATEMAKING TREATMENT FOR THIS EXPENSE?

A. Suez's test period relocation expenses cannot be deemed normal and recurring. Therefore, the appropriate regulatory treatment is to exclude the unusual and non-recurring test period relocation expense from Suez's annual revenue requirement. The adjustment I show on my Schedule 3, page 8, removes a ratemaking allowance for the Company's test period relocation expense.

H. Interest Synchronization Adjustment

Q. PLEASE EXPLAIN THE INTEREST SYNCHRONIZATION ADJUSTMENT THAT YOU SHOW ON SCHEDULE 3, PAGE 9.

A. This schedule shows the required adjustment to state and federal income taxes to synchronize the interest expense tax deduction with the debt portion of the overall return requirement that Mr. Parcell is recommending. The *pro forma* tax deduction for interest expense is the product of the weighted cost of debt and my rate base determination and results in a $1,645 increase in income taxes currently payable.

I. Summary of Operating Results

Q. WHAT IS THE COMBINED EFFECT OF THE COMMISSION STAFF'S RECOMMENDED ADJUSTMENTS TO SUEZ'S OCTOBER 11, 2016 CALCULATION OF ITS REVENUE REQUIREMENT FOR THE TEST PERIOD ENDED JUNE 30, 2016?

A. As shown on my Schedule 3, page 1, Mr. Loy calculated *pro forma* earnings under present rates of $3.942 million for the adjusted test period ended June 30, 2016. The Commission Staff is recommending income adjustments that add $985,154 to Mr. Loy's claimed *pro forma* earnings. Thus, I calculate that Suez's present revenues generate $4.927 million of earnings under *pro forma* conditions for the test period and a 5.51 percent return on rate base.

Mr. Parcell has determined that Suez requires a 9.30 percent return on common equity capital and a 7.38 percent overall return on rate base. Rate levels will have to be increased by approximately $2.847 million to produce a 7.38 percent overall rate of return for Suez. Therefore, I recommend that the rates made effective subject to refund earlier in this proceeding be replaced by rates that reflect the Commission Staff's determination of Suez's current revenue deficiency. It should be kept in mind, however, that a further rate adjustment may be necessitated by the outcome of the continuing inquiry into the new management services agreement proposed by Suez.

Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?

A. Yes, it does. But Staff reserves the right to supplement this testimony at a later date to address the Company's proposed changes to the management services agreement.